

AUDITOR'S REPORT OF THE AUDITOR-GENERAL TO THE FREE STATE LEGISLATURE AND THE COUNCIL ON SETSOTO LOCAL MUNICIPALITY

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I have audited the accompanying financial statements of the Setsoto Local Municipality, which comprise the statement of financial position as at 30 June 2010, and the statement of financial performance, statement of changes in net assets and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory information, as set out on pages ... to

Accounting officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with the South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and in the manner required by the Local Government: Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA). This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor-General's responsibility

3. As required by section 188 of the Constitution of South Africa, 1996 (Act No. 108 of 1996), section 4 of the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA) and section 126(3) of the MFMA, my responsibility is to express an opinion on these financial statements based on my audit.
4. I conducted my audit in accordance with International Standards on Auditing and *General Notice 1570 of 2009* issued in *Government Gazette 32758 of 27 November 2009*. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.
5. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.
6. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

Basis for qualified opinion

Property, plant and equipment

7. The asset register, deemed the only suitable record of the municipality's assets, was not considered to be a reliable record of property, plant and equipment, as no alternative procedures could be performed in instances where the asset register could not provide appropriate audit evidence, as assets with a carrying value of R323 938 733 disclosed in note 8 to the financial statements and the statement of financial position could not be physically verified due to deficiencies in the asset register. These included no descriptions and locations; duplicate registration numbers; and redundant, obsolete or damaged assets that could not be traced.

I could therefore not obtain sufficient appropriate audit evidence to confirm the existence, completeness, presentation and disclosure of, and the municipality's rights to, property, plant and equipment of R323 938 733.

8. Sufficient appropriate audit evidence for capital expenditure of R10 333 150 in the previous year could still not be presented for audit purposes, which would have enabled me to perform the procedures I deemed necessary, resulting in a limitation on the audit. As a result, I was unable to confirm the valuation, rights and obligations and completeness of property, plant and equipment in this regard.
9. In terms of paragraph 22 of SA Standard of GRAP, GRAP 17, *Property, plant and equipment*, where an asset is acquired at no cost, or for a nominal cost, its cost is its fair value as at the date of acquisition. Additions to property, plant and equipment, financed by the Thabo Mofutsanyana District Municipality, were not recorded in the books of the municipality at appropriate amounts and resulted in an understatement of R2 501 939 of infrastructure assets as disclosed in note 8 to the financial statements as well as property, plant and equipment at 30 June 2010, as disclosed in the statement of financial position.
10. Value-added tax (VAT) can only be claimed if supported by a valid tax invoice, as required by section 20(4) of the Value Added Tax Act of South Africa, 1991 (Act No. 89 of 1991 (VAT Act)). During the year, VAT was claimed on invalid VAT invoices which resulted in an understatement of property, plant and equipment of R2 463 466 and an overstatement of VAT receivables.

Finance lease liability

11. In terms of paragraph 34 of GRAP 13, *Leases*, the municipality should have recognised the finance lease liabilities in their statement of financial position at amounts equal to the fair value of the leased property or, if lower, the present value of the minimum lease payments. Contrary to this, finance leases disclosed in note 16 to the financial statements was overstated by R2 499 868, due to lease equipment acquired at amounts significantly higher than the fair value on which the future minimum payments are based.
12. Contrary to the requirements of paragraphs 5 and 12 of GRAP 13, lease payments were erroneously excluded from the finance lease assets thereby understating the finance leases and property, plant and equipment by R2 287 980.

Inventory

13. In the absence of sufficient appropriate audit evidence (including inventory policies and procedures as well as stocktaking reports) to support the inventory disclosure in note 4 of R1 281 881 (2009: R573 880), the rights, valuation, existence and completeness of inventory at year-end could not be verified. Various shortcomings with the administration of inventory were also identified. I could not perform any reasonable alternative procedures to confirm the rights, valuation, existence and completeness of inventory at year-end.

Unspent conditional grants

14. Unspent conditional grants of R32 205 544 (2009: R16 441 776) disclosed in notes 14 and 37.3 to the financial statements were not supported by sufficient appropriate audit evidence and is not backed by investments thus it would seem that conditional grants were used for purposes other than what it was intended for. Owing to shortcomings with the recordkeeping of the municipality, I could therefore not perform alternative procedures to verify the completeness and existence of this liability.

Irregular, fruitless and wasteful expenditure

15. The completeness of irregular expenditure of R27 108 966 disclosed in note 37.3 to the financial statements could not be determined owing to a lack of sufficient, appropriate audit evidence. The application of alternative procedures did not have the desired results owing to weaknesses with recordkeeping of the municipality.

Trade debtors and other receivables

16. Included in total trade and other consumer debtors of R234 762 662 that is disclosed in note 2 to the financial statements were indigent consumer balances of R2 754 930. Sufficient, appropriate audit evidence could not be submitted as to the existence and valuation of these debtor balances.

Capital commitments

17. Appropriate, sufficient audit evidence to substantiate capital commitments of R58 348 509 included with the amount disclosed in note 39, could not be submitted for audit. The application of alternative procedures could not be performed owing to shortcomings in the recordkeeping at the municipality and therefore the obligations, completeness and valuation thereof could not be verified.

General expenses

18. Appropriate, sufficient audit evidence to substantiate payments for goods and services of R9 094 572 included with the amount disclosed in note 31, could not be submitted for audit. The application of alternative procedures could not be performed owing to shortcomings with recordkeeping at the municipality. As a result, the occurrence and completeness of this expenditure were not confirmed.
19. VAT transactions relating to payments for goods and services were understated by R2 124 476 in respect of the incorrect allocation of VAT to the general expenses account. General expenditure was therefore overstated with the same amount.

Cash and cash equivalents

20. Appropriate, sufficient audit evidence to substantiate payments of R16 938 181 could not be submitted for audit. The application of alternative procedures could not be performed owing to shortcomings with recordkeeping at the municipality. As a result, the valuation and completeness of this account balance could not be confirmed.

Related party disclosures

21. I was unable to obtain the information and records needed to confirm whether related party transactions with officials and councillors occurred, due to limitations placed on the scope of my work by the municipality. The municipality's records did not permit the application of alternative audit procedures regarding related party disclosures. Consequently, I did not obtain all the information and explanations I considered necessary to satisfy myself that no related party transactions occurred.

Qualified opinion

22. In my opinion, except for the possible effects of the matters described in the Basis for qualified opinion paragraphs, the financial statements present fairly, in all material respects, the financial position of the Setsoto Local Municipality as at 30 June 2010, its financial performance and its cash flows for the year then ended, in accordance with the SA Standards of GRAP and in the manner required by the MFMA.

Emphasis of matters

I draw attention to the matter below. My opinion is not modified in respect of these matters:

Going concern

23. As disclosed in note 46 to the financial statements there are material uncertainties that may cast significant doubt on the entity's ability to operate as a going concern.

Additional matters

24. I draw attention to the matters below. My opinion is not modified in respect of these matters:

Unaudited supplementary schedules

25. The supplementary information set out on pages 35 to 41 does not form part of the financial statements and is presented as additional information. I have not audited these schedules and accordingly I do not express an opinion thereon.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

26. As required by the PAA and in terms of *General Notice 1570 of 2009* issued in *Government Gazette 32758 of 27 November 2009*, I include below my findings on the report on predetermined objectives, compliance with the Division of Revenue Act, 2009 (Act No.12 of 2009) (DoRA), MFMA, and financial management (internal control).

Predetermined objectives

27. Material findings on the report on predetermined objectives are reported below:
- Non-compliance with regulatory and reporting requirements

No reporting against predetermined objectives, indicators and targets

28. The municipality did not prepare an annual performance report in terms of section 46 of the MSA and section 121(3)(c) of the MFMA.

The performance audit committee was not functioning properly

29. The performance audit committee of the municipality did not discharge its responsibilities as determined in terms of paragraph 14(3)(a) and 14(4(a) of the Local Government: Municipal Planning and Performance Management Regulations, 2001.

Compliance with laws and regulations

Municipal Finance Management Act

The annual budget was not prepared, tabled and approved in accordance with the applicable laws and regulations

30. The mid-year assessment budget was not prepared in the format prescribed by section 21 of the MFMA.
31. Contrary to section 28(3) and 28(4) of the MFMA, the mayor did not table an adjustment budget in the municipal council.
32. Contrary to section 24(1) of the MFMA, the municipal council did not approve the 2009-10 budget at least 30 days before the start of the budget year.

The mayor did not adhere to his legislative reporting responsibilities

33. In terms of sections 127(2) and 127(3) of the MFMA, the mayor of a municipality must, within seven months after the end of a financial year, table in the municipal council the annual report of the municipality. The mayor did not comply with this requirement of the MFMA.

The accounting officer did not adhere to his statutory responsibilities

34. Contrary to section 74(1) of the MFMA, the accounting officer did not submit monthly reports of contracts awarded above the value of R100 000 (VAT included) with a total of value of R45 199 555 to the National Treasury and the provincial treasury, and the department responsible for local government or the Auditor-General.
35. Contrary to section 71 of the MFMA, the accounting officer did not report on the municipality's financial affairs to the mayor and the provincial treasury.
36. Contrary to the requirements of section 72(1)(a) and (b) of the MFMA, the municipal manager did not by 25 January assess the performance of the municipality for the first half of the financial year and did not submit a report on such an assessment to the mayor of the municipality, the National Treasury and the relevant provincial treasury, taking into account the municipality's service delivery performance during the first half of the financial year and the service delivery targets and performance indicators set in the service delivery and budget implementation plan, as required by section 72 of the MFMA.

Municipal officials did not adhere to their statutory responsibilities

- 37. Contrary to section 70(2) and (3) of the MFMA, evidence could not be obtained that the municipality notified the National Treasury of the overdrawn bank account position. The bank balance was overdrawn for a major part of the financial year.
- 38. Senior managers of the municipality exercising financial management responsibilities did not ensure that assets were properly maintained in terms of section 78(1)(e) of the MFMA.

The audit committee was not properly established or not functioning properly

- 39. Contrary to section 166(2) of the MFMA, the audit committee did not discharge its mandate effectively.

Supply Chain Management legislative requirements were not implemented or not adhered to (not resulting in irregular expenditure)

- 40. Goods and services were supplied by the provider and payment made to the provider without a written signed contract which is contrary to paragraph 20(g)(i) of the municipal SCM policy.
- 41. Contrary to section 116(2) of the MFMA, which requires an accounting officer to enforce the conditions of contracts, contracts awarded in previous years totalling R39 539 289 were not monitored and the conditions enforced.

Expenditure was incurred otherwise than in accordance with sections 15 and 11(3) of the MFMA resulting in unauthorised expenditure

- 42. As disclosed in note 37 to the financial statements, expenditure was not incurred in accordance with the approved budget of the municipality and exceeded the limits of the amounts appropriated for the different votes in the approved budget of the municipality.

Expenditure was incurred in contravention of or not in accordance with applicable legislation resulting in irregular expenditure

- 43. Expenditure was incurred which was not in accordance with the municipality's supply chain management policy and resulted in irregular expenditure as defined in section 1 of the MFMA.
- 44. Expenditure was incurred which was not in accordance with the requirements of the Public Officer Bearers Act of South Africa, 1998 (Act No. 20 of 1998) resulting in irregular expenditure as defined in section 1 of the MFMA.

Expenditure incurred was made in vain or could have been avoided resulting in fruitless and wasteful expenditure

- 45. Expenditure was incurred which could have been avoided had reasonable care been exercised resulting in fruitless and wasteful expenditure as defined in section 1 of the MFMA.

Division of Revenue Act

The accounting officer did not adhere to his statutory responsibilities

- 46. Contrary to the requirements of section 42(1)(a) of DoRA, the accounting officer did not submit the budget to the National Treasury by 14 April 2009.
- 47. The municipality did not adhere to the conditions attached to conditional grants by not regularly reporting on the conditional grants in terms of section 74(1) of the MFMA.

INTERNAL CONTROL

- 48. I considered internal control relevant to my audit of the financial statements and the report on predetermined objectives as well as compliance with the MFMA, but not for the purpose of expressing an opinion on the effectiveness of internal control.
- 49. The matters reported below are limited to the significant deficiencies regarding the qualified opinion paragraphs, the findings on the report on predetermined objectives and the findings on compliance with laws and regulations.

Leadership

- 50. Management's philosophy and operating style do not promote effective control over reporting and they do not lead by example.
- 51. Accountability is not emphasised and quality is not understood by all to be a prerequisite and is not embedded in the municipality's values. Performance is not measured.

Financial and performance management

- 52. Management and staff do not fulfil their duties and responsibilities while pertinent information is not identified and captured in a form and time frame to support financial and performance reporting. Requested information was not available and supplied without any significant delay. Systems are not appropriate to facilitate the preparation of the financial statements and performance reports.

Governance

- 53. The municipality does not identify risks relating to the achievement of financial and performance reporting objectives. Internal audit reports are not taken serious and lead to repeat findings that are not resolved. The audit committee did not fulfil its responsibilities as set out in legislation and in accordance with accepted best practice.

OTHER REPORTS

Investigations in progress

54. The executive committee of the council ordered an internal investigation into the spending of monies on a certain project where money was paid for unequal work performed by a certain service provider. At time of this report, this status of this investigation was not known.

Engagement to perform agreed upon procedures engagement

55. As requested by the municipality, an engagement was conducted during the year under review concerning the administration and monitoring of certain contracts and tenders relating to the establishment of solid waste disposal sites. This engagement is not finalised at the time of this report.

Bloemfontein

30 November 2010



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence